



November 29, 2007

Mr. Thomas Johnson, Secretary  
California Department of Veterans Affairs  
1227 O Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Johnson:

**Final Management Letter: Special Review of the Veterans Home of California—Chula Vista's Deficiency Request**

Enclosed is the final management letter on our review of the Veterans Home of California—Chula Vista's Deficiency Request. The California Department of Finance, Office of State Audits and Evaluations, performed this review in accordance with an interagency agreement with the California Department of Veterans Affairs (Department).

The draft management letter issued November 9, 2007 included two observations. The Department's response to the draft report required further analysis. As a result of our analysis, changes were made to reflect the following:

- References to pharmaceutical profit have been removed from Observation 1.
- The Executive Summary and the recommendation to Observation 2 have been revised.

Both the Department's response and our evaluation of the response have been incorporated into this final management letter.

We appreciate the Department's assistance and cooperation with this review. If you have any questions, please contact Frances Parmelee, Manager, or Zach Stacy, Supervisor, at (916) 322-2985.

Sincerely,

*Original signed by:*

Janet I. Rosman, Assistant Chief  
Office of State Audits and Evaluations

Enclosure

cc: Mr. Roger Brautigan, Undersecretary, California Department of Veterans Affairs  
Mr. William Parente, Deputy Secretary for Veterans Homes, California Department of Veterans Affairs  
Mr. Gilbert Acevedo, Administrator, Veterans Home of California—Chula Vista



November 29, 2007

Mr. Thomas Johnson, Secretary  
California Department of Veterans Affairs  
1227 O Street, Suite 300  
Sacramento, CA 95814

Dear Mr. Johnson:

Under an interagency agreement with the California Department of Veterans Affairs (Department), the Department of Finance, Office of State Audits and Evaluations (Finance), performed a review of the Veterans Home of California -Chula Vista's (Chula Vista) Deficiency Request dated September 7, 2007. The Department submitted the deficiency request to Finance requesting \$3.98 million to cover the fiscal year 2007-08 shortfall in Chula Vista's operating budget. Chula Vista cited escalating expenditures in direct patient care and personal service contracts as causes for the deficiency, and requested that the deficiency be funded by \$2 million in excess reimbursements above the current appropriation and \$1.98 million from the General Fund.

#### EXECUTIVE SUMMARY

In evaluating Chula Vista's 2007-08 estimated need, it was determined that the need was overstated. We questioned \$1.3 million, or 4.6 percent of Chula Vista's 2007-08 estimated need of \$28.35 million. Our review indicates the deficiency request should be reduced to \$2.88 million. See Exhibit I for a *Schedule of Estimated, Questioned, and Revised Needs*.

Additionally, Chula Vista's estimate of \$2 million in reimbursements beyond its 2007-08 appropriation is conservative. Based on our review, it is estimated that Chula Vista will collect approximately \$2.9 million beyond its current appropriation. Should an increase in reimbursement authority be approved, our assessment is Chula Vista's deficiency could be funded from this source.

Nonetheless, the deficiency request should reflect a more accurate estimate of excess reimbursements as a funding source for the deficiency. The Department and Finance's Budgets Unit should work collaboratively to determine what portion of the deficiency will be funded through excess reimbursements.

#### BACKGROUND

One of the Department's main objectives is to provide support for California veteran homes where eligible veterans may live in a retirement community and where nursing care and hospitalization is provided. The Department assists eligible veterans with their health care needs by supplying various levels of medical care, social rehabilitation services, and residential services to those residing at veteran homes located in three California locations—Barstow, Chula Vista, and Yountville. Funding for all three homes comes from federal, state, and private sources.

Due to inexperienced budgeting staff and escalating program expenditures, Chula Vista's budgeting process has been insufficient in meeting its overall needs, resulting in budget deficiencies over the past several years. Instead of pursuing increased appropriations, Chula Vista used other means to cover shortfalls, including:

- Redirection of funds allotted for other uses such as maintenance, repairs, and training.
- Redirection of approximately \$1 million in General Fund received for the conversion of a Residential Care Facility for the Elderly (RCFE) to an Intermediate Care Facility (ICF) that never materialized.
- Seeking increased reimbursement authority to spend reimbursements beyond what was budgeted.
- Payment for Chula Vista's expenditures with the Veterans Home of California—Barstow's (Barstow) appropriations.
- Seeking donations to cover expenditures normally funded through program appropriations.
- Payment of prior year expenditures with current year appropriations. Refer to Exhibit III for our analysis of the food contract cost category.

Use of these methods to fund shortfalls and redirect resources has resulted in a baseline budget that has consistently been non-reflective of Chula Vista's actual needs. The Department indicates shortfalls in the current year would limit Chula Vista's ability to maintain the required level of care and service for its residents. As a result, the Department submitted a deficiency request to Finance requesting \$3.98 million to cover the 2007-08 shortfall in Chula Vista's operating budget. Chula Vista requested that the deficiency be funded by \$2 million in excess reimbursements above the current appropriation and \$1.98 million from the General Fund.

## SCOPE

Our review was limited to the \$3.98 million deficiency request. Specifically, the objectives of this review were to:

- Validate the estimated \$3.98 million additional funding need.
- Validate that the estimated \$2 million of the \$3.98 million deficiency could be funded through an increased reimbursement authority.

## METHODOLOGY

To gain an understanding of the processes and controls over Chula Vista's budget, staff at headquarters and Chula Vista as well as Finance Budgets Unit were interviewed. Written procedures related to the Department's budgeting process were reviewed, and the Department's controls over Chula Vista's budget were documented. Additionally, an assessment was performed of the Department's corrective action plan related to the CPS Human Resource Services' *Review of Budget Processes and Fiscal Controls* dated October 18, 2006.

To validate the estimated additional funding need, a limited risk assessment of the deficiency request's *Supporting Schedule of Anticipated Need* was performed. Refer to Exhibit II for that schedule. Cost categories with a significant increase in percent and/or dollar amount over the prior year expenditures were selected for review.

Further, an understanding was gained of the line item composition within each cost category. Where possible, third party schedules, contracts, Department internal spreadsheets, and vendor invoices were used to support Chula Vista's estimated need. Trends were identified by reviewing the accounting records and analyzing prior years' expenditures. The Department of Health and Human Services, Centers for Medicare and Medicaid Services' report dated September 15, 2006, applicable government codes, and the Department's 2007-08 budget change proposals were also reviewed.

To validate that \$2 million of the deficiency could be funded through an increase in reimbursement authority, Department staff at headquarters and at Chula Vista were interviewed. An understanding was gained about the types of reimbursements Chula Vista collects and the controls in place at Chula Vista and headquarters to ensure billable reimbursements are collected. Internal reimbursement estimates prepared by the Department were also reviewed. Trends were identified by reviewing the accounting records and analyzing prior years' expenditures.

Due to the limited scope, only an understanding was gained about the processes and controls over budgeting and reimbursements, and controls were not tested. In some instances, reliance was placed on the Department's internal spreadsheets, interviews with Department staff, and accounting records to base conclusions. As a result, detailed substantive testing was not performed.

## **OBSERVATIONS AND RECOMMENDATIONS**

### **Observation 1—Overstatement of Estimated Need**

Based on our review, several cost categories were overstated. See Exhibit I for a *Schedule of Estimated, Questioned, and Revised Needs*. In total, \$1.3 million, or 4.6 percent of the \$28.35 million estimated need, was questioned. For each cost category that was overstated, we provided the following details below.

- *Salaries (estimated need = \$11,959,095; revised need = \$11,468,772)*

Chula Vista should recognize \$490,323 in salary savings when evaluating resource needs. Based on Chula Vista's average salary saving requirement over the past five years, a 4.1 percent salary savings rate was estimated. That rate was then applied to the estimated salary needs which resulted in \$490,323 of salary savings.

The Department contends no salary savings should be included in the determination of the current year need and that any salary savings would be redirected to meet overtime and registry expenditures to back-fill behind the vacant nursing positions. Vacancy reports provided by Chula Vista indicate that staff vacancies are mainly in non-patient care. These reports also suggest that the percent of vacancies for nursing staff has experienced a downward trend. As of November 1, 2007, only one of the nine vacant positions is for nursing staff. Although Chula Vista contends there are not enough

budgeted positions to meet the nurse care hours required, the current allocated budget for overtime is sufficient to meet Chula Vista's needs. Additionally, Chula Vista recently hired 10 additional permanent and intermittent nursing staff, up 25 percent from the end of the last fiscal year. Use of temporary staff and a contracted nurse registry (both having a budgeted allocation) should assist Chula Vista in back-filling nursing positions should they become vacant.

- *Pharmacy (estimated need = \$1,700,000; revised need = \$1,237,049)*

Our review questions the estimate for pharmacy expenditures by \$462,951. Chula Vista's census both in total and within the different levels of care has remained generally consistent; however, the \$1.7 million estimated need is a 54 percent increase over last year's recorded expenditures.

Chula Vista administers pharmaceutical services for its residents as well as residents at Barstow. Through inquiry of pharmaceutical staff, the estimated need was determined to be Chula Vista's estimated expenditures necessary to provide services for both Chula Vista and Barstow. Since Barstow has its own allocation of \$772,500 for pharmaceutical expenditures and is accounted for separately in the accounting records, Chula Vista's estimated need should be reduced.

The table below represents historical and estimated pharmaceutical expenditures for the two homes.

Fiscal Year	Barstow	Chula Vista	Total	% of Total Increase over Prior Year
2005-06 (Per CalSTARS)	\$314,257	\$1,275,826	\$1,590,083	n/a
2006-07 (Per CalSTARS)	\$636,443	\$1,106,387	\$1,742,830	9.6%
2007-08 (Estimated Need)	\$772,500	\$1,700,000	\$2,472,500	41.9%

Because a review of Barstow's allocation was outside the scope of this review, the reasonableness for the increase in its allocation was not assessed. However, Barstow is opening a new Skilled Nursing Facility (SNF) in January 2008 with a slow but continuous transition to that level of care which may explain its increase.

In figuring Chula Vista's estimated need for pharmaceutical expenditures, we noted that basing a projection built on the prior year's expenditures per the accounting records would not result in an accurate projection. Because of operating deficits towards the end of 2006-07, Barstow paid for \$71,755 of Chula Vista's pharmaceutical invoices. This resulted in overstated recorded expenditures for Barstow and an understatement for Chula Vista by \$71,755. Therefore, we determined Chula Vista's actual 2006-07 expenditures to be \$1,178,142.

Based on the revised 2006-07 expenditures, we applied a 5 percent increase to estimate Chula Vista's 2007-08 current need. The judgmental 5 percent increase was based on the following explanations provided by Chula Vista:

- Chula Vista has an aging population where many members have been there for several years and have been transitioning to the SNF requiring more medications. The complexity of treatments is also increasing.

- Technology advancements in medicines over the past few years have been on the rise. These drugs cost significantly more because they are not generic.
- Chula Vista does not use a formulary; therefore, doctors can prescribe any medications they deem necessary. This eliminates the risk that a crucial medication is unavailable because it was not covered by a formulary.
- Chula Vista only bills Barstow for pharmaceuticals that are not covered by third party insurers. Barstow's pharmaceuticals covered by third party insurers, while reimbursable, still represent an expenditure to Chula Vista. Therefore, Chula Vista believes the opening of the SNF at Barstow will cause an increase to Chula Vista's pharmaceutical need.

Based on our review, the revised need was calculated as follows:

A	B	A + B = C	C *5% = D	C-D = E
2006-07 Recorded Expenditures Per CalSTARS	2006-07 Home Invoices Paid by Barstow	2006-07 Actual Expenditures	Estimated 5% Increase Over Prior Year	Revised 2007-08 Pharmaceutical Need
\$1,106,387	\$71,755	\$1,178,142	\$58,907	\$1,237,049

The combination of Chula Vista's revised pharmaceutical need and Barstow's pharmaceutical allocation (\$772,500) totals \$2,009,549, a 15.3 percent increase over last year's combined actual pharmaceutical expenditures. Our revised need appears reasonable.

- *Other Facilities (estimated need = \$668,980; revised need = \$582,480)*

Our review questions Chula Vista's estimate for Other Facilities expenditures by \$86,500. Specifically:

- The Department has requested and received an annual \$2 million augmentation to replace equipment beyond its functional service life and to procure new equipment to meet functional, emergent regulatory, clinical, and safety requirements. The \$2 million augmentation is handled internally at headquarters. Headquarters uses each veteran home's equipment maintenance and replacement schedule to determine how the funds will be allocated. Within the Alterations line item, Chula Vista has included an estimated expenditure of \$21,500 for the purchase of two composters. This equipment should be added to Chula Vista's equipment maintenance and replacement schedule, and if deemed a priority by the Department, funded through the annual \$2 million equipment replacement program.
- There were several items within the Alterations line item that we consider minor capital outlay projects. Funding for these projects generally should be pursued through the budget change proposal process instead of an allocation in the current year appropriation. However, several proposed minor capital outlay projects could cause health related or personal privacy issues to Chula Vista's residents if not implemented. Examples include installing air handling and

ducting in one of the buildings, installing a privacy ceiling for the Health Information Management Unit, and erecting a wall to create a private office for a psychologist. Therefore, we only question the minor capital outlay projects considered not to have a potential health related or personal privacy impact on the residents. This included an estimated \$65,000 to cut a hillside grade for additional space. This minor capital outlay project should be pursued through a minor capital outlay budget change proposal.

Therefore, the questioned need is:

Purchase of Two Composters	\$21,500
Hillside Grading	<u>65,000</u>
Net Other Facilities Questioned Need	<u>\$86,500</u>

- *Janitorial (estimated need = \$1,440,000; revised need = \$1,242,000)*

The estimated janitorial need is questioned by \$198,000. Chula Vista estimated \$1.44 million for janitorial expenditures, but the janitorial contract was only for \$1.24 million. Chula Vista explained that the current year janitorial contract was implemented as an emergency contract and not signed until June 2007. Originally, the janitorial allocation was an estimate and not based on a contracted amount. Once the contract was in effect, the allocation was not updated to reflect the actual contracted rate.

- *Other Medical Expense (estimated need = \$926,225; revised need = \$882,025)*

The estimated need for Other Medical Expense is questioned by \$44,200. Our review of this cost category revealed several misstated allocations. Specifically:

- Within this cost category, there is an \$88,000 unsupported estimated expenditure. Neither Chula Vista nor headquarters could provide an explanation for the \$88,000.
- In 2006-07, Chula Vista spent approximately \$30,000 in gasoline. The 2007-08 allocation is \$45,000, a 50 percent increase from last year's expenditures. Based on the average price of gas last year versus the average price of gas this year, and assuming Chula Vista uses the same approximate mileage, we question Chula Vista's estimated need by \$5,000.
- Chula Vista failed to allocate resources to the vehicle maintenance line item within this cost category. Based on historical expenditures, vehicle maintenance is underestimated by \$20,000.
- Uniform expenditures were approximately \$25,000 and \$28,000 in 2005-06 and 2006-07, respectively. Chula Vista's current allocation to the uniform expense line item equals \$3,200, an amount Chula Vista indicated was a data entry error. Based on historical expenditures, uniform expenditures are underestimated by \$28,800.

Therefore, the net questioned need is:

Unsupported Projected Expenditure	\$ 88,000
Questioned Gas Need	5,000
Questioned Vehicle Maintenance Need	(20,000)
Questioned Uniform Need	<u>(28,800)</u>
Net Other Medical Expense Questioned Need	<u>\$ 44,200</u>

- *Unallocated Cut from Budget Letter 07-26 (estimated need = \$115,359; revised need = \$97,953)*

Chula Vista's unallocated cut estimate is questioned by \$17,406. Budget Letter 07-26 specifies that 91.42 percent of the general 3.4 percent salary increase would be funded through an augmentation, with the remaining 8.58 percent funded from a redirection of Chula Vista's current appropriation.

Using the May 2007 payroll records, the Department's 8.58 percent portion was calculated at \$648,570; and specifically, Chula Vista's portion was calculated at \$97,953. However, the Deficiency Request's supporting schedule shows this unallocated cut at \$115,359, resulting in a \$17,406 difference.

- *Unallocated Cut from Executive Order No. E 07/08 – 17, Control Section 4.04 (estimated need = \$0; revised need = \$195,000)*

Executive Order No. E 07/08 – 17, Control Section 4.04 (Executive Order) has an affect on our assessment of Chula Vista's need. Its implementation would adversely affect our assessment by \$195,000. In 2006-07, Chula Vista was given a general operating increase of 2.7 percent, equating to an increase of \$195,000. Due to general budget reductions in 2007-08, the Executive Order reversed the prior year 2.7 percent increase, thus reducing the current year appropriation from \$24.373 million to \$24.178 million. Since our review was an assessment of Chula Vista's overall need, this unallocated cut was built into Chula Vista's deficiency by reducing Chula Vista's appropriation accordingly. See the *Schedule of Estimated, Questioned, and Revised Needs* for the calculation.

## **Recommendation**

Revise the Deficiency Request from \$3,979,593 to \$2,875,213 to reflect the \$1,299,380 in questioned needs and the \$195,000 appropriation reduction due to the Executive Order.

## **Observation 2—Understated Reimbursement Projections**

Chula Vista's estimate of \$2 million in reimbursements beyond its 2007-08 appropriation is conservative. Based on our review, we estimate that Chula Vista will collect approximately \$2.9 million beyond its current appropriation, which could serve as a funding source for the current year shortfall.

Chula Vista's Deficiency Request stated that Chula Vista would collect an estimated \$2 million additional General Fund reimbursements in 2007-08 beyond its current appropriation. To



validate Chula Vista's \$2 million estimate, historical reimbursement amounts were evaluated. The table below demonstrates historical and estimated reimbursement amounts:

Fiscal Year	Budgeted	Reimbursements	Difference
2005-06 (actual)	\$6,758,000	\$7,636,805 <sup>2</sup>	\$ 878,805
2006-07 (actual)	\$6,368,000	\$7,796,206 <sup>2</sup>	\$1,428,206
2007-08 (estimated)	\$4,870,000	\$7,796,206	\$2,926,206

The 2005-06 and 2006-07 budgeted amounts reflect anticipated reimbursements for the conversion of the RCFE into an ICF. The 2007-08 reimbursement appropriation dropped \$1.498 million to \$4.87 million due to a reversal of the proposal to convert the RCFE to an ICF. Since an ICF is a higher level of care than the RCFE, Chula Vista would have anticipated a higher reimbursement rate should the conversion take place. Since the conversion never materialized, the 2007-08 budgeted reimbursement amounts were reduced accordingly.

Historical reimbursement amounts indicate that Chula Vista was exceeding budgeted projections even without the conversion of the RCFE to an ICF. Since Chula Vista's census both in total and within the different levels of care has remained generally consistent, a projection based on last year's actual amounts would seem reasonable, if not conservative, based on the following:

- Chula Vista has recently implemented processes to collect reimbursements from HMOs such as Kaiser and Secure Horizons as well as for hospice services.
- Effective August 2007, Chula Vista's Medi-Cal reimbursement rates for the SNF have increased approximately 21 percent.
- The January 2008 SNF opening at Barstow should increase Chula Vista's reimbursements for the pharmaceuticals that are covered by third party insurers and therefore not billed to Barstow.

We project Chula Vista will meet or exceed the 2006-07 reimbursements, and therefore, conservatively base our projection on last year's actual reimbursement amounts as of November 1, 2007 (not including accruals). Therefore, we conservatively project Chula Vista will collect \$7.8 million in reimbursements for 2007-08.

### **Recommendation**

Revise the Deficiency Request to reflect a more accurate estimate of excess reimbursements as a funding source for the deficiency.

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<sup>2</sup> Source—Reimbursement Tracking Sheets provided by the Department. These represent actual reimbursements as of November 1, 2007, and do not include accruals (incurred reimbursable services that have yet to be billed). The eligibility of filing for reimbursement from Medicare and Medi-Cal is 18 months and 12 months from service date, respectively.

The observations in this management letter are based on fieldwork conducted October 1, 2007 through November 7, 2007. We appreciate the Department and Chula Vista's assistance and cooperation with this review. If you have any questions, please contact Frances Parmelee, Manager, or Zach Stacy, Supervisor, at (916) 322-2985.

Sincerely,

*Original signed by:*

Janet I. Rosman, Assistant Chief  
Office of State Audits and Evaluations

**STAFF:**

Frances Parmelee, CPA  
Manager

Zach Stacy  
Supervisor

Steve Backlund  
Jake Liddicoat

# SCHEDULE OF ESTIMATED, QUESTIONED, AND REVISED NEEDS

## Veterans' Home of California—Chula Vista Schedule of Estimated, Questioned, and Revised Needs For Fiscal Year 2007-08

	<u>Estimated</u>	<u>Questioned</u>	<u>Revised</u>
<b>APPROPRIATION:</b>	\$ 24,373,000	\$ 0	\$ 24,373,000
<b>COST CATEGORIES:</b>			
Salaries	\$ 11,959,095	\$ 490,323	\$ 11,468,772
Civil Service –Temp	200,000	0	200,000
Exempt – Residential Help	45,000	0	45,000
Overtime	412,000	0	412,000
Holiday Pay	100,000	0	100,000
Unallocated Cut	<u>115,359</u>	<u>17,406</u>	<u>97,953</u>
Total Salaries	12,831,454	507,729	12,323,725
Staff Benefits	<u>4,440,626</u>	<u>0</u>	<u>4,440,626</u>
<b>TOTAL SALARIES AND BENEFITS</b>	17,272,080	507,729	16,764,351
<b>OPERATING EXPENDITURES</b>			
Food	3,167,516	0	3,167,516
Pharmacy	1,700,000	462,951	1,237,049
Janitorial	1,440,000	198,000	1,242,000
Security	420,000	0	420,000
External Contracts	836,725	0	836,725
Internal Contracts	62,050	0	62,050
Utilities	830,000	0	830,000
Other Medical	926,225	44,200	882,025
General	255,258	0	255,258
Printing	25,300	0	25,300
Communications	140,012	0	140,012
Postage	28,000	0	28,000
Insurance	186,535	0	186,535
Travel	40,650	0	40,650
Training	59,900	0	59,900
Other Facilities	668,980	86,500	582,480
Data Processing	178,563	0	178,563
SWCAP	104,799	0	104,799
Equipment	<u>10,000</u>	<u>0</u>	<u>10,000</u>
<b>TOTAL OPERATING EXPENDITURES</b>	<u>11,080,513</u>	<u>791,651</u>	<u>10,288,862</u>
<b>TOTAL NEED</b>	28,352,593	1,299,380	27,053,213
Unallocated Cut - Executive Order 4.04	<u>0</u>	<u>0</u>	<u>195,000</u>
<b>AMOUNT OF DEFICIENCY</b>	<u>\$ 3,979,593</u>	<u>\$ 1,299,380</u>	<u>\$ 2,875,213</u>

## VHC-Chula Vista FY 2007-08 Deficiency Request

Appropriation	24,935,000	24,373,000	
	06-07 Actuals Exp	FY 07-08 Need	
Schedule 8 Salaries/Wages	11,390,217	11,959,095	Fully funded due to need to provide nursing care through filled positions or overtime or nurse registry.
Civil Service -Temp	194,924	200,000	
Exempt-Resident Help		45,000	
Overtime	409,228	412,000	
Holiday Pay	80,616	100,000	
Unallocated Out Offset		115,359	
Total Salaries/Wages	12,074,985	12,831,454	
Staff Benefits @ 06-07 Rate	4,219,889	4,440,626	
<b>Total PS</b>	<b>16,294,874</b>	<b>17,272,080</b>	
<b>OE&amp;E</b>			
Food Contract	2,447,745	3,167,516	Need set at actual contract costs
Pharmaceuticals	1,106,387	1,700,000	Adjusted for value of in-kind pharmaceuticals provided by Barstow in FY 06-07
Janitorial	1,080,000	1,440,000	Need set at actual contract costs
Security	357,328	420,000	Need set at actual contract costs
External Contracts	757,216	836,725	Need set at actual contract costs
Internal Contracts	94,056	62,050	Need set at actual contract costs
Utilities	721,934	830,000	Inflated at Price Letter estimated inflation.
Other Medical Exp	695,211	926,225	Adjusted for value of in-kind supplies provided by Barstow in FY 06-07
General Expense	255,872	255,258	
Printing	11,008	25,300	
Communications	132,710	140,012	
Postage	21,412	28,000	
Insurance	182,489	186,535	
Travel	11,248	40,650	
Training	15,800	59,900	
Other Facilities Costs	342,224	668,980	
Data Processing Costs	239,973	178,563	
SWCAP	95,599	104,799	
Equipment	724	10,000	
	<b>8,568,936</b>	<b>11,080,513</b>	
<b>Appropriation Balance</b>	<b>71,190</b>	<b>(3,979,593)</b>	

# EXHIBIT III

## ANALYSIS OF THE FOOD CONTRACT CATEGORY

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Our analysis of the food contract cost category did not result in a revised need but provides information for future budgeting purposes. Chula Vista's estimated need for the food service contract is comprised of the following:

2007-08 Contracted Rate	\$ 2,842,516
June 2007 invoice paid in 2007-08 <sup>1</sup>	204,877
Food Contract Benefit Increase (February – June 2007) <sup>1</sup>	33,697
Personal Service Contracts—Salary Increase per Government Code Section 19134 (2007-08 BCP #20)	53,000
Personal Service Contracts—DPA Estimated Benefit Increase Effective February 2008	33,426
Total	<u>\$ 3,167,516</u>

Government Code Section 19134 requires State agencies that enter into personal service contracts to establish contractor wage and benefit rates at no less than 85 percent of the state employer cost of providing comparable wages and benefits to state employees performing similar duties. Due to an anticipated 3.4 percent salary increase, Chula Vista requested and was approved a \$53,000 increase to its 2007-08 appropriation to support the increased expenditure in its personal service contracts (Food Service, Janitorial, and Security). Additionally, in February of each year, the Department of Personnel Administration publishes a revised benefit rate. Any change in the benefit rate could also affect Chula Vista's personal service contract rates. Therefore, Chula Vista, in anticipation of a benefit rate increase, estimated an increase in its 2007-08 personnel service contracts.

The estimated increases in personal service contracts for food, janitorial, and security were built into Chula Vista's estimated need under the Food Contract cost category in the *Supporting Schedule of Anticipated Need* (Exhibit II). This was taken into consideration when evaluating Chula Vista's estimated need for all Personal Service contracts.

Although we do not question Chula Vista's estimated need under the food contract cost category, future estimates should be based on the contracted rate plus any estimated increases deriving from Government Code Section 19134. Future estimates should not be built on the 2007-08 actual expenditures since it includes payments on prior year invoices.

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<sup>1</sup> Represents a one time expenditure and should not be factored in future projections.

## DEPARTMENT RESPONSE

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**DEPARTMENT OF VETERANS AFFAIRS**

OFFICE OF THE SECRETARY

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November 21, 2007

Ms. Janet I. Rosman  
Assistant Chief  
Office of State Audits and Evaluations  
300 Capitol Mall, Suite 801  
Sacramento, CA 95814

Dear Ms. Rosman:

Thank you for the opportunity to respond to the draft management letter on the review of the Veterans Home of California-Chula Vista's deficiency request. I am particularly concerned with the recommendation to source the entire deficiency from excess reimbursements. Your recommendation puts us at risk of having to seek additional legislative relief in the Spring if we do not meet the projections exactly. This risk is unnecessary due to the reversion of any excess reimbursements if the deficiency is sourced at a lower reimbursement amount. This problem is highlighted by the fact that we recently became aware of upcoming Medicare rate reductions that your team did not have for their analysis. Your recommendation needs to be lowered to no more than \$2.25M as being sourced from excess reimbursements. Our detailed comments on specific observations and recommendations are attached.

I would like to thank the Office of State Audits and Evaluations review team for their highly professional and thorough approach to this review. This deficiency request is critical to providing sufficient funding to ensure the health and safety of both our residents and staff. Your team's in-depth review and willingness to listen to the input of our patient care staff was greatly appreciated.

Sincerely,  
Original signed by:  
Thomas Johnson, FACHE  
Secretary

## Enclosure

cc: Mr. Roger Brautigan, Undersecretary  
Mr. Jack Kirwan, Deputy Secretary for Administration  
Mr. Lynn Scott, Assistant Deputy Secretary for Veteran Homes  
Mr. Gil Acevedo, Administrator VHC-Chula Vista  
Ms. Jane Bergman, Assistant Administrator VHC-Chula Vista  
Ms. Joy Hempstead, Chief of Financial Services  
Mr. John Wahlstrom, Budget Officer  
Ms. Robin Baker, Principal Program Analyst, Dept. of Finance  
Ms. Jan Lapanja, Program Budget Analyst, Dept. of Finance

**HONORING CALIFORNIA'S VETERANS**

## **Comments on Observation 1 - Overstatement of Estimated Need**

### Salaries

The Department's original salaries and wages request did not assume any salary savings. This was done due to the fact that overtime, temporary help, and nurse registry have historically not been funded at a rate to meet nursing care requirements in the event positions are vacant. The OSAE recommendation fully funds overtime and temporary help at the same level as actual usage in fiscal year 2006-07. This makes the assumption of some salary savings more manageable. It should be recognized that these funding levels would only be sufficient if the Home can maintain (or reduce) historical vacancy rates. The Department has greater confidence in its ability to prevent further erosion in nursing vacancy rates as a result of anticipated increases in nursing salaries that will make the Home more competitive with the private sector.

### Pharmacy

In estimating cost for fiscal year 2007-08, the OSAE Summary describes Chula Vista as building a "profit" into the pharmaceutical invoices billed to the Veterans Home in Barstow. An examination of the billing methodology implemented by the Chula Vista Veterans Home has revealed that there is no "profit" built into invoicing the Barstow Veterans Home. Since June 2007, the Chula Vista Veterans Home has built into its billing of the Barstow Veterans Home a formulated cost of the share of packaging material ordered and used in dispensing pharmaceuticals. This cost is contained in a "filling fee" that is added on to the direct purchase price of the pharmaceuticals. There is no "profit" made by the Chula Vista Veterans Home. The Department requests the OSAE reference to "profit built in to the pharmaceutical invoices billed to Barstow " be corrected to reflect the actual "filling fee" to cover the cost of packaging material.

## **Comments on Observation 2 – Understated Reimbursement Projections**

In estimating total collections for fiscal year 2007-08, the OSAE findings relied on a simple dollar for dollar comparison. A closer examination of collection patterns and consideration of recently released information (that was not available when OSAE conducted the review) demonstrates that the OSAE estimate for General Fund reimbursement collections is overstated.

An examination of historical collection patterns demonstrates that Chula Vista collects General Fund reimbursements on a very linear rate throughout the fiscal year and through July of the subsequent fiscal year. After that, collections predictably taper off as accrued reimbursements are cleared. For lack of a better term, that period from August forward will be referred to as the tail.

As the following chart shows, collections for fiscal year 2007-08 are following historical

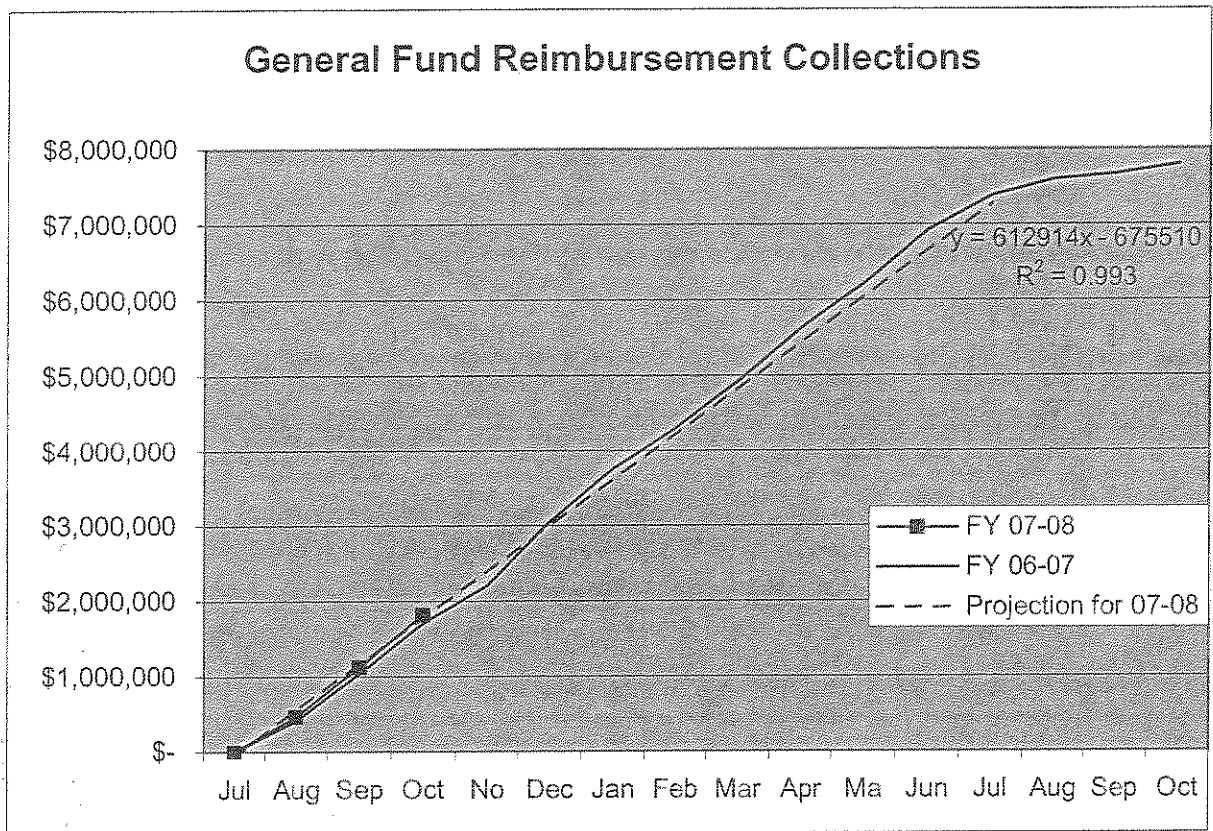


patterns. Using linear regression estimating techniques, we would estimate that the Home would collect \$7,292,000 by July of 2008. This estimate uses actual collections year-to-date and results in a linear regression estimate with an  $R^2$  value of 0.993. ( $R^2$  is a descriptive statistic that tells the analyst how well the estimate fits the actual data, with 1.0 being a perfect fit. Any number above 0.9 is generally considered reliable.) This linear regression estimate is approximately \$91,000 below actual collections last year. Assuming that collections in the "tail" will be identical to last year, this would put the total estimated collections for 2007-08 at \$7,705,000. This assumption is reasonable because it carries less risk of being in error due to the much smaller dollar amount of collections in the "tail" as compared to the total collections.

The Department has been recently informed that the Sustained Growth Rate formula for Medicare will mandate a 10% cut in Medicare reimbursement rates beginning in January 2008. A similar reduction should be factored in for MediCal reimbursement rates due to the potential for MediCal to initiate similar reductions. Using last year's Medicare and MediCal collections as a baseline, we would estimate that this year's Medicare and MediCal collections will be approximately \$134,000 less than last year's.

The Department's current estimate of total General Fund collections at Chula Vista, considering the net impact of these two factors, is \$7,571,000. This amount is \$2,701,000 over the appropriated amount, and substantially less than the OSAE estimate of \$2,926,000 in excess reimbursements.

In the Department's deficiency request, we requested that \$2,000,000 of the deficiency be sourced from these excess reimbursements. While our estimates at that time indicated the Home would collect more than that amount, we felt it necessary to be conservative in the amount that should be sourced from the excess collections. Our rationale for that request was that a) given how early in the fiscal year it was, we did not want to use an assumption that collections would be exactly patterned after last year's collections; b) if the collection pattern for this year fell behind last year's we did not want to have to file another deficiency request; and c) any collections above the requested \$2M amount REVERT TO THE GENERAL FUND and thus reduce the impact to the General Fund to the same level as if we had perfectly prognosticated the excess collections.



## EVALUATION OF DEPARTMENT RESPONSE

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The California Department of Veterans Affairs' (Department) submitted a response to our draft Management Letter on the Veterans Home of California—Chula Vista's (Chula Vista) Deficiency Request. We appreciate the Department's prompt response and general concurrence with our observations and recommendations. For the Department's comments that require a response, we provide the following comments.

### **Observation 1—Overstatement of Estimated Need**

#### *Salaries*

The Department concurred with our observation that salary savings should be recognized, assuming Chula Vista has been adequately funded for overtime and temporary help in the event that nursing positions become vacant. Although future vacancy rates are unpredictable, we reiterate that vacancy rates for nursing staff have been experiencing a downward trend. Additionally, we concluded that Chula Vista's 2007-08 assessment of need for overtime and temporary help appeared reasonable based on prior year usage and actual expenditures through the first quarter of fiscal year 2007-08. Therefore, we maintain our position that Chula Vista should recognize approximately \$490,323 in salary savings.

#### *Pharmacy*

The Department's response did not oppose our recommended revised need for pharmaceutical expenditures, but questioned our understanding that a profit is built into the pharmaceutical invoices billed to the Veterans Home of California—Barstow (Barstow). As such, our reference to "profit" has been removed since it does not have a fiscal implication to our revised pharmaceutical need. To fully understand the processes and expenditures for providing pharmaceutical services to Barstow and Chula Vista, a more in-depth study would be necessary.

### **Observation 2—Understated Reimbursement Projections**

The Department performed a linear regression of collections based on approximately three months of 2007-08 actual collections and projected reimbursements to be \$7,705,000, a 1.2 percent reduction from our projection of \$7,796,206. The Department did not consider the following factors that could possibly increase reimbursements:

- Effective August 2007, Chula Vista's Medi-Cal reimbursement rates for the Skilled Nursing Facility (SNF) increased approximately 21 percent. The ongoing effect of this increase would not be captured in the Department's projection.
- The January 2008 SNF opening at Barstow should increase Chula Vista's reimbursements for pharmaceuticals covered by third party insurers and therefore not billed to Barstow.

The Department also indicated that the Sustained Growth Rate formula for Medicare will mandate a 10 percent cut in Medicare reimbursement rates beginning January 2008, resulting in an estimated \$134,000 reduction in reimbursements. Since these rate reductions were not available during our fieldwork, and the Department did not include supporting documentation with its response, this information was not incorporated into our reimbursement projections.

We concur that a relatively conservative estimate is reasonable to avoid further deficiency requests. However, it appears that the Department is overly conservative when estimating reimbursement projections. Even in its response, the Department estimated reimbursements at \$2.7 million but requested us to further lower our projection to \$2.25 million.

We will not change our reimbursement projections of \$2.9 million. However, because information not available to us could affect the accuracy of our projection, our recommendation and Executive Summary has been modified to account for the possibility. We reiterate that the reimbursement projection should be realistic; one to which Chula Vista should be held accountable. The Department and Finance's Budgets Unit should work collaboratively to determine what portion of the deficiency will be funded through excess reimbursements.